CONNECTICUT CONFERENCE OF MUNICIPALITIES

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THE VOICE OF LOCAL GOVERNMENT

# TESTIMONY

of the

## CONNECTICUT CONFERENCE OF MUNICIPALITIES

to the

## FINANCE, REVENUE AND BONDING COMMITTEE

March 2, 2009

CCM is Connecticut's statewide association of towns and cities and the voice of local governments - your partners in governing Connecticut. Our members represent over 93% of Connecticut's population. We appreciate this opportunity to testify before you on issues of concern to towns and cities.

CCM supports **H. B. 6561, "AAC Municipal Revenue Diversification."**

This bill would allow municipalities the option of enacting a 1% sales tax, a 1% food and beverage tax and a 4% lodging tax. It would also allow municipalities above 80,000 in population to enact "land value" taxes. It also provides that in the first two years of local option taxation, while the economy and the state budget are still weak, the State could deduct the cost of collection from the revenue raised

**Local option taxes mean that the people who live and pay taxes in towns and cities would be able to decide best what mix of revenue sources work best for their community.** That mix may not be the same in every municipality. In a state in which there is a clear over-dependence on property taxes, and in an environment where financial help from the State will be limited it is time for Connecticut to discuss allowing towns and cities more flexibility and provide them with more revenue diversity.

### Property Tax Dependence

Connecticut statutes dictate that towns and cities are dependent on one tax — the property tax — for the vast majority of their revenue. But it's been clear for years that the property tax can no longer carry the burden by itself — it is a regressive tax that is not adequate for the task of funding local government services in the 21st Century.

In early America, the property tax made sense as a proxy for wealth. The people in town with the most property, case any more. People on fixed or slowly growing incomes own homes whose value has risen significantly since they purchased the property (despite the recent slump in the housing market). Their property taxes rose with the increased values. The property tax, however, is income blind. Your property tax liability has no relation to how much you earn or whether you've lost your job and life savings — you just have to pay it.

What worked in 1809 doesn't work in 2009.

The per capita property tax burden in Connecticut is \$2,042, an amount that is almost twice the national average of \$1,123, and 2nd highest in the nation. And it doesn't get much better when Connecticut's wealth is taken into account: Connecticut ranks 4$^{th}$ in property taxes as a percentage of personal income (\$6.10 per \$100 of income, compared with the national average of \$5.10).

Connecticut is more dependent on property taxes to fund local government than any other state in the nation. It also is the 2nd most dependent on property taxes to fund education. That means that the educational opportunity a child has is directly tied to the property tax wealth of the community in which he or she lives.

The property tax in Connecticut is the largest single tax on residents and businesses in our state. Overall, property taxes account for 37% of all state and local taxes paid in our state. Property taxes are the biggest tax on businesses. In FY 06-07, Connecticut businesses paid over $700 million in corporate income taxes — but over $900 million in property taxes.

Statewide, 69% of municipal revenue comes from property taxes. Most of the rest, 23%, comes from state aid. Some Connecticut municipalities are almost totally dependent on property taxes to fund local government. Nine towns depend on property taxes for at least 90% of all their revenue. Another 48 municipalities rely on property taxes for at least 80% of their revenue.

**Most States Allow Local Revenue Diversity**

Only 15 states allow municipalities just the property tax.

➢ **23 states** allow at least some municipalities to levy both **property and sales taxes**
➢ **6 states** allow at least some municipalities to levy both **property and income taxes**, and
➢ **5 states** allow at least some municipalities to levy all three — **property, sales and income taxes**.

Plus, remember that most other states have county governments that levy taxes in addition to state and local taxes, and that provide public services. When people consider moving to other states they often come back talking about how low the taxes are — but they are often referring to *property* taxes, the need for which is off-set by optional local taxes, county taxes and higher state income tax rates. [For example, of the 43 states with a personal income tax, 29 have income tax rates that reach higher than Connecticut's highest rate of 5%. They include states we typically think of as our economic competitors: North Carolina (7.75%), South Carolina (7%), Georgia (6%) and our neighbors New York (6.85%) and Massachusetts (5.3%). Yet, as we've seen above, Connecticut's property taxes are second highest in the nation.]

**Can Local Taxing Authority Work In Connecticut?**

What works in other states may not work successfully in Connecticut. We're a small state, divided 169 ways. Other states are geographically larger, have unincorporated areas that get few services, and have county governments. One concern about granting municipalities the power to levy additional taxes is that municipalities that are poorer and have higher property tax rates will most likely be the ones that choose to levy additional taxes. In a small state like ours that might make the poorer/high tax communities even less competitive over time when it comes to attracting business investment, homeowners, etc. That would be counterproductive. **But inadequate state funding of non-education municipal aid is pushing more and more communities – particularly Connecticut's most distressed municipalities -- to look at local option taxes because of their desperate need for non-property tax revenues.**

**Local Option Taxes**

Local-option taxation allows citizens of the municipality to decide what mix of taxes works best for their community.

As proposed in the bill before you today, municipalities would be allowed to levy local-option taxes on sales, food/beverages and lodging as a way to take pressure off of property taxes. For example, locally levied sales taxes and hotel occupancy taxes would be able to be considered in municipalities where those industries are strong.

If every municipality were to enact a 1% sales tax – a highly unlikely event -- it would increase local revenue by $550 - $600 million. **Is there any other proposal out there that would deliver so much to relieve property tax pressures and continue local services?**

CCM estimates that a 1% tax on food and beverages would raise about $42 million statewide, while a 4% lodging tax would raise in the neighborhood of $4 million.

HB 6561 would also allow municipalities above 80,000 in population to enact a "land value" tax by which a municipality could decide to assess vacant land at a higher rate. Although it would add to local revenue diversity, a "land value tax" is really an "in-fill" tool – a way to encourage development of vacant property. For that reason it is most appropriate for highly populated, highly developed communities.

We urge, however, that this option be available to distressed municipalities regardless of population. An city like New London, for example, has a small land area with little space for new development – except on vacant or underutilized parcels. They should have this option.

**Other Approaches For Local Revenue Diversification**

1. **Make local taxes applicable statewide**

One very straightforward approach would be for the State to add new sources of municipal revenue, but do so on a *statewide* basis. In this way all municipalities would be able to relieve pressures on the property tax, while avoiding any competitive harm that would arise if only certain municipalities applied the tax. For example, the State could authorize all municipalities to collect a local tax on lodging. The money would be kept by any municipality with a hotel, motel, B&B, etc. One attractive aspect of hotel taxes is that they export most of the tax to out-of-state visitors, rather than place the revenue burden on locals. Another example would be to raise the state sales tax and share the increase with towns and cities.

This piggyback approach makes administrative sense. There is precedent for applying local taxes on a statewide basis. The State already dictates that property taxes are the primary source of municipal revenue, and it applies the base municipal real estate conveyance tax evenly across all 169 municipalities.

2. **Allow municipalities to assess alternative taxes on a regional basis**

If alternative sources of local revenue were an option open to *regions* it would allow local elected officials, working with their neighbors, to levy the taxes that would fit best with their particular region. It would combine the advantages of local revenue enhancement while tailoring it to regional needs and avoiding negative competition between urban centers and suburbs. For example, a local-option sales tax might drive retail activity to the suburbs and away from cities, but an optional sales tax applied on a regional basis would not have the same effect — if the retailers want access to the market of a given region, the tax would apply no matter where they locate. Of course, regional consensus is often difficult to reach, hence the allure of local-option authority as discussed above.

CCM recommends that the State encourage the transition of all regional planning organizations (RPOs) into regional councils of government (COGs). Presently, there are three kinds of regional entities, one of which — regional planning agencies — comprise appointees and not elected officials. COGs are made up of chief elected officials — people who are accountable to the voters of their communities for their decisions. Any other type of regional entity would be inappropriate for greater fiscal authority. The State should enact an expedited process to encourage the transition of all regional organizations to COGs. Granting local-option taxing authority to COGs would not just diversify the municipal revenue base. It would be a major step towards increasing regional cooperation and thus improve overall governmental efficiency.

3. **Share state revenues with municipalities or regions**

Another way to diversify local revenue would be for the State to share portions of state revenue streams with municipalities. For example, the State could share a portion of the sales tax with the municipalities or region in which the tax is collected. This would avoid the political and administrative travails associated with levying new taxes, although it would affect state revenue. However, the State could specify that municipalities receive all, or a portion of, any increases in state sales tax revenue above the levels anticipated in the present state budget. In that way, the State would never lose revenue, but towns and cities would stand to gain. The State could also use a piggyback approach (as discussed above) and share any increase in state taxes with towns and cities.

**Summary**

Local option taxation is controversial. But in 2009, more than any previous year, local officials need and want tools and flexibility to allow them to maintain service continuity and the quality-of-life in their communities. One of the best things the State can do, given its own budget troubles, is to provide these tools – even if it's only on a temporary basis during the economic crisis. Where local option taxes are under consideration local officials – elected and accountable to their citizens – would have to shoulder the responsibility for levying them.

What has worked for Connecticut before isn't working today. We need new approaches and new solutions as we meet the current economic and budgetary challenges.

***We urge you to favorably report this bill.***

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